

**STATE OF ILLINOIS**

**ILLINOIS COMMERCE COMMISSION**

<b>MidAmerican Energy Company</b>	:	
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<b>Verified Petition for Declaratory</b>	:	<b>03-0496</b>
<b>Ruling or in the Alternative,</b>	:	
<b>Application for Approval of</b>	:	
<b>Affiliated Interest Contract.</b>	:	

**PROPOSED INTERIM ORDER**

By the Commission:

**I. INTRODUCTION**

On August 19, 2003, MidAmerican Energy Company ("MEC") filed with the Illinois Commerce Commission ("Commission") a verified petition for a declaratory ruling or, in the alternative, an application for approval of an affiliated interest contract. MEC made the filing pursuant to 83 Ill. Adm. Code 200.220, 83 Ill. Adm. Code 310.60, and Section 7-101(3) of the Public Utilities Act ("Act"), 220 ILCS 5/1-101 et seq. At the heart of this matter is MEC's acquisition of two Siemens Westinghouse 501F combustion turbines from its ultimate parent company, MidAmerican Energy Holdings Company ("MidAmerican Holdings"), in July of 2001. MEC seeks a declaratory ruling that its acquisition of the turbines from MidAmerican Holdings is exempt from the need for Commission approval under the terms of Section 310.60 of Part 310, "The Waiver of Filing and the Approval of Certain Contracts and Arrangements with Affiliated Interests." If the Commission denies its request for a declaratory ruling, MEC requests that the Commission approve its acquisition of the turbines as an affiliate agreement pursuant to Section 7-101(3) of the Act.

Commission Staff ("Staff") filed a response to MEC's petition recommending that the request for the declaratory ruling be denied and that this matter proceed in a manner consistent with MEC's alternative request. MEC submitted a reply to Staff's response maintaining its support for its request for the declaratory ruling. No hearings have been held in this matter. The Commission will dispose of the request for the declaratory ruling on the basis of the written submissions before it in accordance with Section 200.220(h).

**II. GOVERNING LAW AND RULES**

Section 7-101 of the Act governs transactions among affiliated interests. Subparagraph (3) provides in relevant part that:

(3) No management, construction, engineering, supply, financial or similar contract and no contract or arrangement for the purchase, sale, lease or exchange of any property or for the furnishing of any service, property or thing, hereafter made with any affiliated interest, as hereinbefore defined, shall be effective unless it has first been filed with and consented to by the Commission or is exempted in accordance with the provisions of this Section or of Section 16-111 of this Act. The Commission may condition such approval in such manner as it may deem necessary to safeguard the public interest. If it be found by the Commission, after investigation and a hearing, that any such contract or arrangement is not in the public interest, the Commission may disapprove such contract or arrangement. Every contract or arrangement not consented to or excepted by the Commission as provided for in this Section is void.

Subparagraph (4), however, provides that the Commission may by general rules applicable to all public utilities waive the filing and necessity for approval of contracts and arrangements described in subparagraph (3) in certain situations. One such situation concerns “contracts or arrangements made in the ordinary course of business for the purchase of services, supplies, or other personal property at prices not exceeding the standard or prevailing market prices, or at prices or rates fixed pursuant to law.” Section 310.60 implements subparagraph (4).

Section 200.220 of the Commission’s Rules of Practice concern declaratory rulings. Section 200.220(a) provides that the Commission may in its sole discretion issue a declaratory ruling with respect to the applicability of any statutory provision enforced by the Commission or of any Commission rule to the person requesting a declaratory ruling. It is pursuant to Section 200.220 that MEC seeks a finding that it need not comply with Section 7-101(3) of the Act due to the waiver provided for in Section 310.60.

### **III. MEC AND THE AFFILIATE TRANSACTION**

According to the petition, MEC is an Iowa corporation with its principal office located in Des Moines, Iowa. As an electric public utility subject to the jurisdiction of the Commission within the meaning of Sections 3-105 and 16-102 of the Act, MEC is engaged in the business of producing, transmitting, and delivering electricity to the public in Rock Island, Henry, Whiteside, and Mercer counties in Illinois and in other states. Approximately 10% of MEC’s 2002 revenues from electric service were derived from customers in Illinois. MEC notes that it is also subject to the jurisdiction of the Federal Energy Regulatory Commission, the Iowa Utilities Board, and the South Dakota Public Utilities Commission.

MEC is a direct wholly-owned subsidiary of MHC Inc., which in turn is wholly-owned by MidAmerican Funding, LLC. MidAmerican Funding, LLC is a direct, wholly-owned subsidiary of MidAmerican Holdings. In light of these relationships, MEC

acknowledges that it is an affiliated interest of MidAmerican Holdings under Section 7-101 of the Act.

Along with its petition, MEC submitted the prepared testimony and affidavit of Dean Crist, MEC's Vice President of Regulatory Projects. Mr. Crist testifies that MidAmerican Holdings conducted a solicitation process in the third quarter of 1999 to obtain the combustion turbines. He states that there were three potential vendors for combustion turbines of desired capacity and performance: ABB, GE, and Siemens Westinghouse. MEC contacted each of these potential vendors. Mr. Crist testifies that ABB was only providing units as a part of a turnkey package, which would include a complete plant (combustion turbine, steam turbine, and heat recovery steam generator) with 2003 and later deliveries and there were reported operating problems with previous ABB engines. For these reasons, Mr. Crist reports that ABB was eliminated from consideration. With regard to GE, he states that it was not able to provide a quote with the requested delivery schedule due to its order backlog. Siemens Westinghouse did have manufacturing capability to provide units with delivery in 2002. Mr. Crist indicates that the units were to be a design similar to the Cordova Energy Center. Because of the delivery and compatibility advantages, Siemens Westinghouse was selected as the supplier and negotiations were undertaken.<sup>1</sup> During the negotiations, Mr. Crist testifies that the experience gained from the Cordova Energy Center combustion turbine procurement was used to optimize the design and pricing of the units given market conditions at the time. He indicates that the negotiation process was completed and a contract ("Turbine Agreement") was signed on May 26, 2000. The total contract price was \$70,034,335, and was subsequently revised to \$71,736,708.

Mr. Crist asserts that MidAmerican Holdings did not acquire the combustion turbines specifically for MEC. At the time of the turbine solicitation, he states that the MidAmerican Holdings generation project furthest along in development was a Wisconsin merchant plant. After MidAmerican Holdings executed the Turbine Agreement with Siemens Westinghouse, however, MEC's need for the turbines for its Greater Des Moines Energy Center ("GDMEC") project advanced more rapidly than the Wisconsin merchant plant project. He states that the GDMEC project advanced due to the enactment of Iowa legislation that removed certain disincentives to investor-owned utilities constructing and owning new generation. He notes further that the Wisconsin project was delayed due to environmental permitting. Consequently, MidAmerican Holdings and MEC agreed to transfer the Turbine Agreement. Mr. Crist testifies that MEC reimbursed MidAmerican Holdings for its costs with six payments totaling \$21,521,012 that occurred from June 2000 through July 2001 from MidAmerican Holdings to Siemens Westinghouse. He adds that MEC compensated MidAmerican Holdings for capitalized interest of \$488,004 and for miscellaneous expenses of \$2,245.70. The allocation of the capitalized interest and miscellaneous expenses has been recorded below-the-line so that no part of this expense is reflected in rate base for Illinois customers.

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<sup>1</sup> Siemens Westinghouse is not an affiliated interest of MEC or MidAmerican Holdings.

Under his direction, Mr. Crist states that available options for acquiring turbines for the GDMEC project were reviewed. In light of MidAmerican Holdings' aforementioned experience in acquiring the two turbines, Mr. Crist testifies that Siemens Westinghouse was the only viable option for a turbine generator. In order to meet the projected "in-service" dates for the GDMEC project, he states that the decision was made to take assignment of the turbines from MidAmerican Holdings in July 2001.

#### **IV. MEC's POSITION**

MEC argues that its acquisition of MidAmerican Holdings' rights, obligations, and interests in the Turbine Agreement meet the criteria for a waiver under Section 310.60(b) of the Commission's rules. Specifically, MEC asserts that its acquisition of the Turbine Agreement constitutes a contract or arrangement made in the ordinary course of business for the purchase of personal property at prices not exceeding prevailing market prices. Implementation of the rule, MEC continues, reflects the intention of the Commission to provide a level of assurance to utilities that they do not need to file this type of agreement. MEC argues that the exemption will be eviscerated and of no use to utilities if the Commission determines that it needs a hearing in order to make individual factual determinations for each "ordinary course" transaction. MEC maintains that this is clearly not the result intended by the Commission or the General Assembly.

The first question is whether the Turbine Agreement is a "contract or arrangement." MEC maintains that the Turbine Agreement clearly constitutes a "contract or arrangement." A copy of the Turbine Agreement and associated documents are attached to Mr. Crist's testimony.

As for the "ordinary course of business" aspect of the waiver criteria, MEC insists that a major business activity of both it and MidAmerican Holdings is the construction, ownership, operation, and maintenance of electric power generation facilities. MEC contends that the acquisition and disposition of components of electric generators such as turbines is a key part of the electric power generation business. In its 2002 10K report filed with the United States Securities and Exchange Commission, MidAmerican Holdings described its business as follows:

MidAmerican Energy Holdings Company and its subsidiaries ... is a United States-based privately owned global energy [sic]. The Company's subsidiaries' principal businesses are regulated electric and natural gas utilities, regulated interstate natural gas transmission and electric power generation.

MEC further states that one of the business platforms of MidAmerican Holdings is CalEnergy-Domestic, which is engaged in independent power production. MEC explains that the business of independent power production also involves owning, constructing, operating, and maintaining electric generation equipment.

According to MEC, the acquisition of electric generation equipment such as turbines is an essential part of its business of providing regulated bundled electric service. MEC asserts that it owns and operates 26 combustion turbines with a capacity of over 1,100 megawatts. In the past 14 years, MEC continues, it has purchased five combustion turbines. MEC points out that it currently has three electric generation projects in various stages of development in order to meet its customers' demands for electric power. When the three projects are constructed, MEC states that the majority of its rate base, or 70%, will consist of the costs of electric generation assets.

With regard to the "personal property" criteria, MEC avers that the affiliated interest transaction did not involve the purchase of realty or fixtures. At the time of the transaction, MEC states that the transaction involved the purchase of pieces of equipment that were considered personal property under Iowa law. MEC directs the Commission's attention to Iowa Code (2003), Section 4.1(21).

MEC also argues that the price of the turbines under the Turbine Agreement clearly does not exceed the prevailing market price. In order to confirm that the price for the turbines under the terms of the assigned Turbine Agreement reflected the prevailing market price of comparable turbines at the time of the affiliate interest transaction, MEC secured affidavits from two unaffiliated power supply experts. According to the petition, the price of the turbines specified in the Turbine Agreement was not disclosed to the experts. MEC Exhibits 1.4 and 1.5 are affidavits of Jeffrey Grieg, consulting engineer for Burns and McDonnell Engineering Company, and Irving Suss, a power equipment broker for Continental Power Machinery Inc. MEC contends that both Mr. Grieg and Mr. Suss considered the price of units other than ones manufactured by Siemens Westinghouse. MEC asserts that these affidavits establish that the prevailing market price for two comparable turbines at the time of the affiliated interest transaction (July 2001) was \$70 million to \$80 million. MEC points out that the affiliated interest transaction price of \$71.7 million is at the very low end of the prevailing market price range specified by the independent experts. MEC also considers it significant that both men affirm that delivery times for newly ordered combustion turbines would have been a minimum of 18 to 24 months. MEC contends that these delivery times would not have met its needs.

MEC objects to Staff's reference to the \$5,000,000 limit that Section 7-101(4)(c) places on affiliate transactions for which the filing requirements may be waived. MEC does not dispute that the value of the Turbine Agreement is far greater than the threshold provided for in Section 7-101(4)(c). Because, however, the value of the transaction is not among the criteria identified for consideration under Section 7-101(4)(b), the provision under which MEC files its request, MEC finds Staff's reference improper. MEC also points out that the amount of its generation rate base allocated to the Illinois retail jurisdiction is approximately 10%, which means that the portion of the Turbine Agreement that will ultimately be reflected in Illinois retail rates is roughly \$7.1 million.

As additional support for the declaratory ruling request, Mr. Crist testifies that a delay in acquiring turbines for the GDMEC project would have reduced the benefits of the project to customers. He states that benefits derived from the timely acquisition of the turbines and completion of the project include (1) enhanced transmission system reliability, (2) lowered overall energy costs resulting from displacement of older, less efficient existing gas-fired generation and reduced dependence on the volatile wholesale energy market, (3) meeting the increased capacity needs of customers, and (4) assistance in replacing expiring power purchase agreements.

As for Staff's comment that MEC considered only one turbine vendor, MEC asserts that there is no dispute that MidAmerican Holdings conducted a proper competitive solicitation for turbines in the third quarter of 1999. When it decided to acquire turbines, MEC states that it was necessary to step into a queue of turbines already under contract or find a turbine on the secondary market. Mr. Christ, MEC continues, conducted a review of turbine options, which included the results of MidAmerican Holdings' turbine solicitation as well as input from MEC generation personnel. At the time that it needed the turbines, MEC maintains that demand for combustion turbines was just as tight as it had been a year prior when the MidAmerican Holdings solicitation had been completed. MEC insists that conducting a second review process so soon after MidAmerican Holdings completed its review process would not have made sense.

## **V. STAFF'S POSITION**

Staff urges the Commission to deny MEC's request for a declaratory ruling on the grounds that it necessitates a factual determination by the Commission based solely upon facts alleged by MEC. The factual determination that most concerns Staff is the notion that MEC paid the prevailing market price at the time of the assignment of the Turbine Agreement. Staff asserts that MEC's petition, on its face, raises questions as to whether MEC's agreement to acquire the turbines reflects the prevailing market value. Staff first points out that MEC offers no affidavit as to the prevailing market rate for combustion turbines from sources other than Siemens Westinghouse. MEC directed its experts, Staff observes, to only consider the cost of acquiring combustion turbines manufactured by Siemens Westinghouse. Other potential vendors such as ABB and GE, Staff continues, were not solicited by MEC. Putting aside whether the appropriate market to consider was combustion turbines manufactured by Siemens Westinghouse, Staff asserts that MEC's petition in effect asks the Commission to accept on its face the conclusions reached by MEC's experts and for the Commission to make the factual determination that the transaction was made at the prevailing market rate without the benefit of input of any party other than MEC. According to Staff, such a factual determination based solely on the naked assertions of MEC is not appropriate given the complexity of the issue.

The value of the Turbine Agreement is also significant in Staff's opinion. Staff calculates the \$71.7 million contract to be 14 times the limit set by the legislature for general contracts exempted from 7-101(3). Section 7-101(4)(c) provides that the

Commission may by rule waive the filing and necessity for approval of contracts and arrangements between affiliated interest where the total obligation to be incurred under such contract or arrangement does not exceed the lesser of \$5,000,000 or 2% of the utility's receipts from all tariffed services in the preceding calendar year. Staff is aware that MEC is claiming the exemption under Section 7-101(4)(b).

The other argument that Staff relies on in urging the Commission to deny MEC's declaratory ruling request is that the transaction between MEC and MidAmerican Holdings was not made in the ordinary course of business. Staff notes that MEC did not solicit bids for combustion turbines from other potential vendors besides its affiliate. In contrast, Staff observes that the ordinary course of business for MidAmerican Holdings, a company whose principal business is the construction of power production facilities, is to conduct a solicitation process to obtain bids. MidAmerican Holdings, Staff continues, solicited three potential bidders (ABB, GE, and Siemens Westinghouse) before deciding to enter into a contract with Siemens Westinghouse. To justify its acquisition of the Turbine Agreement, Staff recounts that MEC witness Crist simply concluded that the Siemens Westinghouse turbines from MidAmerican Holdings were the only viable option for MEC. This transaction was not ordinary, Staff concludes, it was extraordinary. MEC's petition, Staff claims, ignores this important set of facts.

The apparent underlying reason for why MEC sought to acquire the combustion turbines, Staff states further, also establishes that this transaction in fact was not in the ordinary course of business for MEC. Prior to July of 2001, Staff reports that MEC determined that (1) it needed to replace the capacity of supply arrangements that were expiring in 2004 and (2) it allegedly needed intermediate or peaking capacity to be in place by the summer of 2003. Prior to July of 2001, Staff asserts that MEC had also planned on meeting those capacity requirements with new power supply arrangements. Staff indicates that the aforementioned July 2001 change in Iowa law, however, led MEC to determine that GDMEC should be constructed. Staff argues that MEC's decision to go ahead with GDMEC to meet its energy needs put MEC under a set of circumstances much different than it had anticipated resulting in it acting outside of its ordinary course of business. Staff maintains that MEC should not be allowed to now exempt this transaction from Commission review due to a business decision it made on its own.

## **VI. COMMISSION CONCLUSION**

On the surface, MEC's acquisition of the Turbine Agreement might appear to satisfy the terms of Section 7-101(4)(b) of the Act and Section 310.60(b) of Part 310. The Turbine Agreement is clearly a "contract or arrangement." MEC and MidAmerican Holdings both from time to time purchase turbines, which arguably places MEC's acquisition of MidAmerican Holdings' turbines in the category of "ordinary course of business." No one disputes that the turbines should be considered "personal property" at the time of their acquisition. MEC's acquisition of the turbines at essentially the price paid by MidAmerican Holdings also arguably satisfies the pricing component of subsection (4)(b).

Upon further review, however, the Commission can not conclude with certainty that the manner in which MEC acquired the turbines was in the ordinary course of business and that the price it paid did not exceed the standard or prevailing market price. With regard to the manner in which it acquired the turbines, nothing in the record suggests that it is “in the ordinary course of business” for MEC to turn to its affiliate for goods and services outside of an existing affiliate agreement. In light of the closer review warranted by affiliate transactions, the Commission is reluctant to find that such a significant purchase from an affiliate is in the ordinary course of business. The argument that MidAmerican Holdings reviewed turbine purchase options in the third quarter of 1999 and that therefore it would have been redundant for MEC to conduct another complete review in early 2001 is interesting, but does not unquestionably place MEC’s acquisition of the Turbine Agreement from MidAmerican Holdings within the ordinary course of business.

Similarly, the Commission is not prepared to conclude that the purchase price under the Turbine Agreement does not necessarily exceed the standard or market price. Although MEC includes affidavits from two unaffiliated power supply experts, the Commission notes that MEC only asked the experts to determine the cost of a Siemens Westinghouse 501F gas turbine generator. To be fair, MEC argues that both experts considered the price of units other than ones manufactured by Siemens Westinghouse. This may be true, but given that they were not asked to do so, the extent to which they considered the price of other units is unclear. The Commission might be more inclined to agree with MEC’s position if there was no question about the degree to which the experts reviewed the price of gas turbines from other sources. This is not to say that the Siemens Westinghouse turbines would not have been the best option, but that the Commission can not conclude as much based on the record.

For these reasons, the Commission concludes that MEC’s declaratory ruling request should be denied and that this matter should proceed as an application for approval of an affiliated interest contract under Section 7-101(3) of the Act. Nothing in this Interim Order should be construed to mean that MEC’s acquisition of the Turbine Agreement from MidAmerican Holdings will be found to be contrary with the public interest. Whether the arrangement between MEC and MidAmerican Holdings is in the public interest will be determined in the next stage of this proceeding.

## **VII. FINDINGS AND ORDERING PARAGRAPHS**

The Commission, having reviewed the entire record and being fully apprised in the premises, is of the opinion and finds that:

- (1) the Commission has jurisdiction over the subject matter of this proceeding;
- (2) the recitals of fact and conclusions reached in the prefatory portion of this Interim Order are supported by the record and are hereby adopted as findings of fact;

- (3) MEC's request for a declaratory ruling should be denied; and
- (4) this matter should proceed as an application for approval of an affiliated interest contract under Section 7-101(3) of the Act, pursuant to MEC's alternative request for relief.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that MidAmerican Energy Company's request for a declaratory ruling is hereby denied.

IT IS FURTHER ORDERED that this matter should proceed as an application for approval of an affiliated interest contract under Section 7-101(3) of the Public Utilities Act.

IT IS FURTHER ORDERED that this Interim Order is not final and is not subject to the Administrative Review Law.

DATED: November 18, 2003

Briefs on Exceptions must be received by December 2, 2003.

Briefs in Reply to Exceptions must be received by December 9, 2003.

Administrative Law Judge